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SUBJECT: SECOND QUARTER REVIEW OF THE SOUTH AFRICAN ECONOMY WITH KEY ECONOMIC STATISTICS

¶1. (U) Summary. South Africa's real GDP rebounded in the second quarter of 2008, reflecting a recovery in mining and manufacturing production as electricity supply improved. Export volumes benefited from the increased production, higher international prices of key export commodities increased, and the depreciation of the rand. Consequently, the current account deficit narrowed in the second quarter and was easily financed by the inflow of portfolio and other investment capital. This in turn improved South Africa's gross reserve position and enabled the rand to recover some of its first quarter-losses. Unemployment also dropped from 23.5 percent in the first quarter to 23.1 percent in the second quarter. CPIX-inflation accelerated to 13.0 percent in July 2008, driven mainly by supply-side factors. Responding to the deteriorating inflation outlook, the Monetary Policy Committee (MPC) raised the repurchase rate (repo rate) at its April and June meetings. The repurchase rate was left unchanged at 12 percent in August. End Summary.

Sources are from the South African Reserve Bank (SARB), Statistics SA, and the Customs Department of the South African Revenue Service. Some figures from previous months may have changed as the result of statistical revisions.

¶I. MONTHLY FIGURES

¶2. EXCHANGE RATES
Rand/US Dollar Exchange Rate (monthly average):

2007		2008	
May 7.02	Sep 7.13	Jan 6.99	May 7.62
Jun 7.17	Oct 6.77	Feb 7.64	Jun 7.92
Jul 6.97	Nov 6.70	Mar 7.98	Jul 7.64
Aug 7.23	Dec 6.83	Apr 7.79	Aug 7.67

Trade-Weighted Rand (monthly average; 2000 = 100):

2007		2008	
May 79.53	Sep 76.68	Jan 75.78	May 67.41
Jun 78.20	Oct 79.51	Feb 69.03	Jun 65.03
Jul 79.16	Nov 78.67	Mar 63.95	Jul 66.87
Aug 76.49	Dec 77.99	Apr 65.31	Aug 66.32

Comment: The rand recovered some of its first quarter losses during the second quarter. On balance, the rand depreciated by 11 percent against the dollar and 15 percent against the weighted average exchange rate of the rand in the first eight months of 2008. The rand declined sharply in the first quarter as the risk premium demanded by non-resident investors increased. This decline was also influenced by factors such as electricity supply disruptions, slowing growth and negative perceptions arising from attacks on foreigners. The rand recovered some of its first quarter losses

during April and May following an aggressive reduction in interest rates by the US Federal Reserve in conjunction with higher South African interest rates, buoyant commodity prices, and significant direct investment inflows arising from corporate deals. The value of the rand declined in June in response to a lower-than-anticipated interest rate increase and the announcement of a larger-than-expected current account deficit for the first quarter. The depreciation in June was further aggravated by the Fitch rating agency's decision to change the outlook for South Africa's long-term issuer default rating from positive to stable. The strengthening of the rand in July and August was supported by the rebound in domestic output during the second quarter. Analysts expect the future value Qoutput during the second quarter. Analysts expect the future value of the rand to be shaped by South Africa's ability to fund its current account deficit. End Comment.

¶3. INFLATION (year-on-year, not seasonally adjusted)

	2008				
	Mar	Apr	May	Jun	Jul
CPI	10.6	11.1	11.7	12.2	13.4
CPIX	10.1	10.4	10.9	11.6	13.0
PPI	11.9	12.4	16.4	16.8	18.9

Comment: Many inflation-targeting economies overshot their inflation targets during the last year due to rising food and fuel prices, and South Africa was no exception. CPIX-inflation (CPI less mortgage interest) breached the upper limit of the inflation target range of 3 to 6 percent in April 2007 and accelerated to 13.0 percent in July 2008. The acceleration resulted primarily from higher food prices, high international oil prices and mounting broad-based price pressures or second-round effects. The SARB's Monetary Policy Committee (MPC) expects inflation to peak at an average rate of around 13 percent in the third quarter of 2008.

Thereafter, inflation is expected to decline in the first quarter of 2009, in part because of the introduction of new inflation basket weights. Inflation is than expected to decline gradually, and to fall below the upper end of the inflation target range in the second quarter of 2010. PPI-inflation scaled new heights (well above those of consumer prices) due to widespread increases in the prices of both domestically produced and imported goods. End Comment.

¶4. MONEY AGGREGATES (percentage change over 12 months)

	2008				
	Mar	Apr	May	Jun	Jul
M1	15.46	10.11	12.39	14.33	7.63
M2	19.94	20.07	19.43	18.07	13.93
M3	20.98	21.10	20.90	20.28	18.50

Comment: Growth in the broadly defined money supply (M3) continued to decelerate during the first seven months of 2008, restrained by the tighter credit and the general economic slowdown. Despite the slowdown, growth in M3 remained high, supported by accelerating inflation with its impact on nominal income and expenditure. Weak share, bond, and real-estate prices also triggered a stronger precautionary and speculative demand for money balances. End Comment.

¶5. DOMESTIC CREDIT EXTENSION TO THE PRIVATE SECTOR (percentage change over 12 months)

2008				
Mar	Apr	May	Jun	Jul
22.62	19.63	19.74	20.39	19.81

Comment: The tightening of credit conditions contributed to a moderation in the growth of credit to the private sector during the second quarter of 2008. Tightening monetary policy increased the debt-service costs for an already indebted private sector, while lending standards for the household sector were raised in accordance with the National Credit Act (NCA). Furthermore, consumers' purchasing power was eroded by inflation, and household balance sheets were undermined by stagnant house prices and increasingly volatile financial markets. The deteriorating economic climate was evident in weakening business and consumer confidence. Economists believe this downward trend will continue in the second-half of

¶2008. End Comment.

¶6. KEY INTEREST RATES (at end of month)

2007	Apr	May	Jun	Jul	Aug
SARB Repo Rate	11.50	11.50	12.00	12.00	12.00
Prime Overdraft Rate	15.00	15.00	15.50	15.50	15.50

Comment: The MPC has hiked interest rates ten times (for a cumulative 500 basis-points) since June 2006, making the current tightening cycle the longest since South Africa adopted an inflation-targeting framework. This has reversed most of the 650-basis-point reduction between 2003 and 2005. The repurchase rate (repo rate) was left unchanged at 12.0 percent in August 2008. Most analysts believe that interest rates have peaked and that the first interest rate cuts can be expected from the second quarter of
¶2009. End Comment.

¶7. MERCHANDISE TRADE ACCOUNT (R millions)

2008	EXPORTS	IMPORTS	TRADE BALANCE
Jan	39,356.8	49,573.2	-10,216.4
Feb	46,946.3	52,766.1	-5,819.8
Mar	51,150.9	56,181.0	-5,030.1
Apr	56,174.3	66,169.0	-9,994.7
May	56,240.5	57,900.0	-1,659.5
Jun	60,159.9	60,343.8	-183.9
QJun	60,159.9	60,343.8	-183.9
Jul	61,268.2	75,599.6	-14,331.4
TOTAL (1)	367,761.0	418,431.1	-50,670.1
JAN - JUL 2007			
TOTAL (1)	275,760.0	316,683.8	-40,923.8

(1) Total After Adjustments (year-to-date)

Comment: Strong international prices and demand for South African mining products, alongside the depreciation of the rand, caused merchandise exports to increase by 32 percent in the first seven

months of 2008. There was a rise in the volume of manufactured exports such as chemical products, machinery and electrical equipment, and vehicles and transport equipment. Imports were boosted by an even greater amount by the government's capital expansion program as well as strong fixed investment spending by the private sector, high international oil prices and the weaker rand. End Comment.

¶8. FOREIGN RESERVES ($ billions)

	2008 Mar	Apr	May	Jun	Jul
SARB Gross Gold and Foreign Reserves	34.39	34.28	34.41	34.85	35.00
SARB Net Open Forward Position	33.13	32.97	33.23	33.76	34.17

Comment: South Africa's gross reserve position improved from $25.6 billion at the end of 2006 to almost $33.0 billion at the end of 2007, and by a further $2 billion to $35.0 billion by the end of July 2008. Analysts believe the SARB has adopted a more cautious approach to reserve accumulation to avoid unnecessary downward pressure on the rand. South Africa's reserves remain low as a percentage of exports, when compared to other emerging market economies. Furthermore, import coverage decreased from five-and-a-half to four weeks of imports as imports surged in July. This is regarded as a source of weakness by the major international credit rating agencies. End Comment.

II. QUARTERLY FIGURES

¶9. REAL GROSS DOMESTIC PRODUCT (percent change, seasonally adjusted and annualized)

	2007 Q2	Q3	Q4	2008 Q1	Q2
Primary Sector	-4.5	1.9	-1.1	-13.9	16.9
Agriculture	8.3	4.4	11.2	17.2	19.6
Mining	-9.1	0.9	-5.8	-25.1	15.6
Secondary Sector	2.0	0.6	8.1	1.0	12.3
Manufacturing	-0.1	-2.5	8.2	-1.0	14.5
Electricity	2.8	3.0	-1.8	-6.2	-1.3
Construction	11.8	14.7	14.2	14.9	10.6
Tertiary Sector	5.9	6.8	5.1	4.2	1.4
Trade & catering	4.7	4.5	2.1	3.6	-2.2
Transport & Comm.	6.1	4.4	3.6	3.5	4.1
Finance	10.2	12.3	8.5	4.9	2.3
Government	1.2	3.3	4.4	4.6	1.1
TOTAL	4.0	4.6	5.1	2.1	4.9

Comment: South Africa's real GDP rebounded in the second quarter of 2008 and expanded at an annualized rate of 4.9 percent, following a sluggish growth rate of only 2.1 percent in the first quarter. The improvement in growth in the second quarter reflected increased output in the primary and secondary sectors, which offset a further moderation in output growth of the tertiary sector.

Primary sector: Growth in the agricultural sector edged higher in the second quarter of 2008, primarily due to favorable weather conditions for field crop production, combined with a marked increase in the acreage planted. The mining sector recovered some of its first quarter losses. Production of gold, diamonds, coal and platinum increased in the second quarter of 2008, even though mines Qplatinum increased in the second quarter of 2008, even though mines had to operate at power levels of between 90 and 95 percent of their earlier electricity requirements. The more stable supply of electricity and favorable commodity prices more than offset the loss of production due to continuing, but fewer, safety-related shutdowns over the period.

Secondary sector: Growth in the secondary sector expanded in the second quarter primarily due to the improved performance of manufacturing. The strong manufacturing performance was partly attributable to base effects as the availability of electricity supply improved considerably in the second quarter. The increase in manufacturing production was especially pronounced in food and beverages, and petroleum-related products. Electricity output contracted only marginally in the second quarter of 2008 as the

availability of electricity improved considerably and the export of electricity to neighboring countries declined. The construction sector remained buoyant in the second quarter of 2008, although the increase in output was lower than in the first quarter. This moderation in growth reflected deteriorating conditions in the residential and non-residential building sectors, as developers increasingly felt the strain of higher interest rates and mounting inflationary pressures.

Tertiary sector: The slower pace of growth in the tertiary sector reflected a slowdown in the trade sector. The contraction in the trade sector was the first since the third quarter of 2001 and was primarily due to slower output growth in the retail and motor trade subsectors. Tighter credit conditions and inflationary pressures negatively affected consumer spending and consumer confidence levels in the second quarter of 2008. Likewise, growth in the finance sector also tapered off. End Comment.

¶10. BALANCE ON CURRENT ACCOUNT (R millions)

	2007 Q3	Q4	2008 Q1	Q2
Merchandise Exp.	124,858	132,032	138,702	172,558
Net Gold Exports	10,239	11,268	11,516	11,877
Merchandise Imp.	150,425	152,374	161,339	188,055
Income Payments	29,752	31,868	31,607	28,862
Current Account	-45,314	-38,072	-41,089	-39,133
Current Account Deficit/GDP (percentage)	-8.1	-7.5	-8.9	-7.3

Comment: The second quarter output recovery after power supply disruptions in the first quarter, coupled with high international commodity prices and a more competitive rand, resulted in significant increaQs in both the volume and average price of South African exports in the second quarter. This improved export performance coincided with more subdued domestic demand and a marginal increase in imports, and resulted in the narrowing of the current deficit in the second quarter of 2008. End Comment.

¶11. BALANCE ON FINANCIAL ACCOUNT (R millions)

	2007 Q3	Q4	2008 Q1	Q2
Direct Investment	10,880	5,528	35,169	981
Portfolio Investment	29,215	-6,055	-20,572	22,547
Other Investment	16,015	34,863	29,688	19,150
Financial Account	56,110	34,336	44,285	42,678

Comment: South Africa continued to attract capital inflows to finance the current account deficit in the second quarter of 2008. Unlike the first quarter of 2008, when portfolio investments turned negative, capital inflows in the second quarter were primarily portfolio and other investment capital. Foreign investor confidence in the country was positively affected by the recovery in output and high commodity prices, coupled with the government's commitment to address structural shortages. However, the South Africa economy Qaddress structural shortages. However, the South Africa economy would have to generate similar capital inflows in the second-half of 2008 to prevent the rand from depreciating further. End Comment.

¶12. KEY LABOR MARKET VARIABLES (thousand)

	2007 Mar	Sep	2008 Q1	Q2
Employed	12,648	13,234	13,623	13,729
Unemployed	4,336	3,945	4,191	4,114
Total Labor Force	16,984	17,178	17,814	17,844
Not Econ. Active	13,211	13,235	12,794	12,861
Population 15-64	30,195	30,413	30,608	30,705
Unemployment rate	25.5	23.0	23.5	23.1

(percentage)

Absorption rate (Employed/population ratio)	41.9	43.5	44.5	44.7

Comment: Unemployment in South Africa dropped from 23.5 percent in the first quarter of 2008 to 23.1 percent in the second quarter. The number of jobless persons decreased by 77,000 to 4.1 million

people, while the number of employed persons increased by 106,000 to 13.7 million. The prospect of slower economic growth for the next year or two could slow down or even halt this progress on employment. End Comment.

III. ANNUAL FIGURES

¶13. GROSS DOMESTIC PRODUCT
(R millions, at market prices)

	2005	2006	2007
Nominal GDP	1,541,067	1,741,060	1,993,894
GDP Growth Rate	5.0	5.4	5.1

(constant 2000 prices, y-o-y growth percentage)

Comment: The strong growth in 2007 was due to high commodity prices, strong domestic consumer demand, and increased fixed capital investment. Economists expect economic growth to slow to between 3 percent and 4 percent in 2008. This slowdown is due to the sustained monetary policy tightening since mid-2006, energy supply constraints, and slower global growth. End Comment.

¶14. FINANCING OF GROSS CAPITAL FORMATION (R millions)

	2005	2006	2007
Savings by Households	1,264	-5,164	-6,885
Corporate Savings	35,598	21,140	14,118
Savings of Government	-10,836	9,032	19,636
Consumption of fixed capital	190,148	218,070	255,033
Gross savings	216,174	243,078	281,648
Foreign Investment	62,179	112,346	145,016
Gross capital formation	278,353	355,424	426,664
Gross Savings/GDP (percentage)	14.0	14.0	14.1
Dependence on Foreign Investment	22.3	31.6	34.0
Foreign Investment/GDP (percentage)	4.0	6.5	7.3
Gross Capital Formation/GDP (percentage)	18.1	20.4	21.4

Comment: The savings rates for households and corporations continued to decline, while the government increased its savings rate in 2007. The government's higher savings rate was mainly due to an increase in tax revenue collected which more than offset growth in expenditure. Notwithstanding the minor improvement in the national savings/GDP ratio, South Africa's dependence on foreign capital to finance gross capital investment increased to its highest rate ever in 2007. Investment programs by private business enterprises, public corporations, and the general government boosted growth in capital investment. The ratio of gross fixed investment to GDP increased to its highest level since 1985 and is approaching the SAG's target of 25 percent. End Comment

¶15. NATIONAL BUDGET (R billions)

Fiscal Year Ending 31 March:

	2005	2006	2007	2008
Total Revenue	347.4	411.2	481.2	560.1
Total Expenditure	368.6	416.8	470.2	541.6
Budget Balance	-20.7	-5.0	11.0	18.5
Budget Balance/GDP	-1.4	-0.3	0.6	0.9

Comment: The fiscal surplus in 2008, only the second since 1960, was the result of a large increase in tax revenue (owing to strong economic activity and stepped up revenue enforcement) that was only partly absorbed by additional expenditure. End Comment.

¶16. GOVERNMENT DEBT (R billions)

Fiscal Year Ending 31 March:

	2005	2006	2007	2008
Total Debt	501.7	528.5	551.9	571.7
of Which:				
-- Domestic	431.8	461.2	469.0	475.2
-- Foreign	69.4	66.8	82.6	96.2
-- Other debt	0.5	0.4	0.3	0.2
State Debt Cost	48.9	50.9	52.2	52.8
Government Debt/GDP (percentage)	36.8	33.2	28.9	25.4
State Debt Cost/GDP (percentage)	3.4	3.2	2.9	2.6

Comment: The decline in government debt as a percentage of GDP can be attributed to the rapid growth of the economy and the creation of a fiscal surplus. Debt service costs have shown a steadily declining trend since peaking at 5.6 percent of GDP in the 1999 fiscal year. The decline in debt service costs has created the necessary "fiscal space" to finance social priorities. End Comment.

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For additional information please consult the following websites:

South African Reserve Bank
South African Revenue Service
Statistics South Africa
National Treasury

BOST